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INSURANCE CONSUMER COUNSEL'S COLUMN

DEFEATING THE "STEP-DOWN" CLAUSE IN AUTO INSURANCE

BY PROFESSOR GREG MUNRO¹

Introduction

Plaintiff's counsel is always relieved to obtain the auto policy declarations page and find adequate, i.e., 100,000/300,000 limits of Bodily Injury, Uninsured Motorist, and Underinsured Motorist coverage for coverage of the claimant's injuries. However, it is becoming more common to then discover that a clause in the policy or endorsement reduces those limits to a statutory minimum \$25,000 for the "named insured" or "family member." Or, the clause reduces the tortfeasor's insurance to the statutory minimum because he was a non-family permissive user. This article addresses the increasingly occurring situations where such "step-down" clauses are inserted to defeat coverage for particular classes of claimants.

A "step-down" clause in an auto insurance policy reduces the declaration page amounts to a certain minimum coverage when the claimant or the driver is a member of certain defined classes. The two common classes of persons identified to suffer reduction of benefits are (1) the "named insured and any family member," (what the author will call the "family" step-down), and (2) "a person other than the named insured or family members," (what the author will call the "permissive user" step-down). Hence, the first is used to reduce coverage benefits to family, and the other, ironically, to reduce coverage benefits to non-family.

Background of the clauses that step-down benefits to family

These two types of step-down clauses have very different rationales for their inclusion in the policies. The first has its roots in tort principles of family immunity. Historically, the common law enforced an immunity between spouses and also parental

immunity from suits by children.² The immunities were based on the idea that such suits would be fictitious and fraudulent and disrupt peace and harmony in the home.³ Most states have now rejected those rationalizations and abolished the immunities.⁴ Montana abrogated tort immunity between spouses in *Miller v. Fallon County* in 1986,⁵ noting that the presence of insurance would prevent family harmony from being destroyed. In *Transamerica Ins. Co. v. Royle* in 1983,⁶ the Montana Supreme Court abrogated intra-family tort immunity holding that a parent was not immune from suit by a child in part because of the "prevalence of insurance."

This was no consolation to insurers more worried than ever about the prospect of collusion between family members. Consequently, the industry protected itself from the perceived threat by use of "family" or "household" exclusions that appear in the forms used for property/casualty coverage in the United States. Family or household exclusions were and are designed to block any recovery for family members by simply excluding coverage. Arguably, they are simply family tort immunity resurrected. The reader is referred to the author's previous articles about family exclusions⁷ and invalidating such exclusions⁸ for treatment of family and household exclusions in general.

Background of the clauses that step-down benefits to permissive users

The second type of step-down clause reduces liability coverage for permissive drivers other than family members. The author will call it the "permissive driver" step-down clause. Its genesis is quite different from that for family members. When auto

insurers accept an application from a family, they have a certain amount of underwriting information on each family driver, i.e., accident experience, licensing, age, traffic violations, vision, disabilities, and even school grades. This information assists the carrier in assessing and allocating risk to the appropriate risk pool. The insurer has no such underwriting information on permissive users "other than the named insured and family members."

Moreover, auto liability insurers have had to deal with a wave of court decisions extending to all classes of permissive users coverage under the "omnibus clause," (the clause that extends coverage to drivers operating the vehicle with the owner's permission).⁹ The courts were swayed by mandatory omnibus clause statutes, which they viewed as supporting "a strong public policy of providing compensation to accident victims."¹⁰

Obviously, the insurer would like to exclude coverage for the class of permissive users other than the named insured and family members. However, family exclusions and permissive user exclusions each run afoul of state statutes mandating insurance coverage. Essentially, if a statute mandates that a particular coverage be carried, i.e., Bodily Injury Liability coverage in Montana¹¹ or that it be offered, i.e., Uninsured Motorist coverage in Montana,¹² an insurance provision that excludes a class of persons from coverage by the terms of the policy in derogation of the statute, is likely void as against public policy. Hence, In *Transamerica Ins. Co. v. Royle* in 1983,¹³ the Montana Supreme Court declared the family exclusion invalid on the ground that the Mandatory Liability Protection Act required insurance against bodily injury to "any person" and made no exception for bodily

injury to family members. Said the court, "The legislature has expressly outlawed the 'household exclusion.'"¹⁴

The outright exclusion of liability coverage for a permissive user fares no better. In *Swank v. Chrysler Ins. Corp.* in (1997),¹⁵ a garage policy of an auto dealer excluded the dealer's permissive users (its customers using loaner cars) from liability coverage except insofar as they didn't have personal coverage that met the mandatory minimum limits under state statute. The court held that the provision excluding coverage of customers who had their own coverage was void because it didn't meet the mandatory minimum coverage for "all vehicles owned or operated" in Montana.¹⁶

To avoid having exclusions stricken for violating public policy, insurers designed step-down clauses that only excluded coverage in excess of the statutory minimums. Hence, instead of excluding coverage for family members or permissive users, the step-down clauses would reduce their coverage to the state statutory minimum limits of the respective coverage.

Examples of the step-down clause limiting family member recovery to minimum limits

The Montana Federal District Court's decision in *Shook v. State Farm Mutual ins. Co.*¹⁷ (1994) involved a step-down clause that limited recovery for a family or household member under the Bodily Injury Liability coverage to minimum statutory limits:

There is no coverage: 2. For any bodily injury to: c. Any insured or any member of the insured's family residing in the insured's household to the extent the limits of liability of this policy exceed the limits of liability required by law.

In New Mexico's case of *Martinez v. Allstate Ins. Co.* (1997),¹⁸ Allstate's policy excluded from Bodily

Injury Liability coverage for:

bodily injury to any person related to an insured person by blood, marriage or adoption and residing in that person's household, to the extent that the limits of liability for this coverage exceeds the limits of liability required by the [name of state] Financial Responsibility law.

In the New Mexico decision of *State Farm Mutual Automobile Insurance Company v. Ballard*,¹⁹ (2002), the step-down exclusion for family makes clear its direct connection with intra-familial immunity in tort:

THERE IS NO COVERAGE:

* * *

2. FOR ANY BODILY INJURY TO:

c. ANY INSURED OR ANY MEMBER OF AN INSURED'S FAMILY RESIDING IN THE INSURED'S HOUSEHOLD:

(1) IF INTRA-FAMILIAL TORT IMMUNITY APPLIES; OR

(2) TO THE EXTENT THE LIMITS OF LIABILITY OF THIS COVERAGE EXCEED THE LIMITS OF LIABILITY REQUIRED BY LAW IF INTRO FAMILIAL TORT IMMUNITY DOES NOT APPLY.

Progressive Casualty Insurance Company's family step-down clause in the BI liability coverage to the minimum has been tailored in an attempt to avoid having it found ambiguous after the Montana Supreme Court decisions in *Liebrand v. National Farmers Union Property and Casualty Co.*, and *Cole v. Truck Ins. Exchange*:²⁰

NO COVERAGE IS PROVIDED UNDER THIS PART I FOR **BODILY INJURY TO YOU OR A RELATIVE FOR**

THE PORTION OF DAMAGES THAT EXCEEDS THE MINIMUM LIMITS OF LIABILITY COVERAGE REQUIRED BY THE MANDATORY MOTOR VEHICLE LIABILITY INSURANCE LAW OF THE STATE OF MONTANA, PURSUANT TO MT. CODE § 61-6-301 AND § 61-6-103, AS AMENDED (MINIMUM REQUIRED LIMITS ARE CURRENTLY \$25,000 EACH PERSON FOR **BODILY INJURY**/\$50,000 EACH **ACCIDENT FOR BODILY INJURY**.²¹

USAA's auto policy form 5100MT (1999) contains the following family step-down clause in the BI coverage:

C. There is no coverage for **BI** for which a **covered person** becomes legally responsible to pay a member of that **covered person's household**. This exclusion applies only to the extent that the limits of liability for this coverage exceed \$25,000 for each person or \$50,000 for each accident.

Examples of step-down clauses limiting permissive users' recovery to minimum limits

Generally, the permissive user step-down clauses limit liability coverage to a specified amount (less than what is shown on the declarations page) or to the minimum prescribed by the state's financial responsibility laws.²² In the Missouri case of *Windsor Ins. Co. v. Lucas*,²³ (2000) the policy defined an "insured" in the liability portion of the policy as:

"insured(s)" means. . . . [a] person using your insured car with your permission. The limits of liability for a permissive user will be equal to minimum limits of liability specified by the

Financial Responsibility Law of the state in which the accident occurs.

This clause was coupled with a "Limits of Liability-Part A only" clause that read:

Regardless of the limits of liability shown on the Declarations page the bodily injury and property damage liability. . . for each insured, other than you and a relative, will equal the limits of the Financial Responsibility Law of the state in which the accident occurred.

In 2006, District Judge Holly Brown (Gallatin County) voided a step-down clause aimed at permissive users in Mid-Century Insurance Company's auto liability policy.²⁴ That policy used a standard insuring agreement and limits of liability clause with a declarations page that showed no evidence of the step-down clause. The step-down clause first appeared in the company's "Other Insurance" provision:

We will provide insurance for an **insured person**, other than you or a **family member**, up to the limits of the Financial Responsibility Law only.

The policy also contained an Amendatory Endorsement which provided:

We will provide insurance for an **insured person**, other than you, a **family member** or a **listed driver**, but only up to the minimum required limits of your state's Financial Responsibility Law of \$25,000 per person and \$50,000 per **occurrence** for **bodily injury**, and \$10,000 for **property damage**.

Treatment of step-down clauses for permissive users


The "vast majority" of courts do not treat permissive user step-down clauses as illegal.²⁵ The courts find support for the clauses in parties' freedom to contract and on the fact that the clauses still provide minimum limits in compliance with the law.²⁶ Insurance scholar, Professor Johnny Parker, asserts that, in all but two jurisdictions, "step-down provisions do not violate public policy as long as they provide the minimum limits of coverage required by law."²⁷ Insurers' argument that the permissive users present an unknown and unpredictable risk may be persuasive for the courts. It would seem easier to attack the step-down clauses aimed at family members than permissive users.

Nevertheless, Judge Brown ruled a step-down provision aimed at permissive users void for ambiguity, lack of conspicuousness, violation of public policy, unconscionability, and violation of reasonable expectations.²⁸ MTLA member, Dan Buckley, presented the challenge to the clause.

Montana treatment of the step-down clauses

Judge Hatfield of the United States District Court for Montana made the earliest pronouncements regarding permissive user step-down clauses in *Guaranty National Insurance Company v. Kemper Financial Services* in 1987.²⁹ There, a rental car agency carried a policy that covered it for liability with limits of \$1,000,000 but only covered its rental customers for the minimum limits required under Montana law. Robison, an employee of Kemper Financial Services, rented an auto and was involved in a collision causing injury to third persons. Kemper and Robison asserted that Guaranty owed the \$1,000,000 limit available to the named insured as opposed to the \$25,000 limit available under the step-down provisions of the agreement. They argued that the step-down aspect violated Montana public policy and that the insuring agreement was ambiguous. Judge Hatfield rejected both arguments.

Kemper and Robison relied upon the Montana Supreme Court's 1983 decision in *Bill Atkinson Volkswagen, Inc.*³⁰ involving a garage policy that covered the named insured but excluded its customers using loaner cars to the extent they had their own liability insurance. The court had ruled that such an exclusion was void as violative of the Montana Mandatory Liability Protection Act, § 61-6-301 *et. seq.* Judge Hatfield, however, distinguished between the policy that excludes coverage for the permissive user and one that reduces coverage to amounts required by Montana law. He noted that the Motor Vehicle Safety



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Responsibility Act, § 61-6-103(8), MCA (1985) provided:

(8) Any policy which grants the coverage required for a motor vehicle liability policy may also grant any lawful coverage in excess of or in addition to the coverage specified for a motor vehicle liability policy and such excess or additional coverage shall not be subject to the provision of this part. With respect to a policy which grants such excess or additional coverage the terms "motor vehicle liability policy" shall apply only to that part of the coverage which is required by this section.

Said Hatfield, "This court views subsection (8) as expressly sanctioning coverage beyond the statutory minimum requirements for any particular insured under the policy."³¹ He found the public concern to be satisfied when one purchased insurance in amounts required by the Act.³²

The Missouri case of *Gabriel v. Shelter Mut. Ins. Co.*,³³ is in accord with *Kemper*. There, the court noted that the Motor Vehicle Financial Responsibility Law in Missouri permitted coverage in excess of the minimums and provided that "such excess or additional coverage shall not be subject to the provisions of this chapter." Montana's Motor Vehicle Safety Responsibility Act, MCA § 61-6-103(8), contains the identical quoted language. This makes it harder to argue that Montana's Mandatory Liability Protection Act, which refers to provisions of the Motor Vehicle Financial Responsibility Law, invalidates the family exclusion for amounts over the minimums.³⁴

However, insurance consumer counsel should keep three aspects of *Kemper* in mind: First, *Kemper* involved a step-down clause for permissive users distinguishing it from cases considering step-down clauses reducing coverage for family members. It is

easier to attack the family step-down clause because its application seems so arbitrary and unfair as to make it vulnerable to public policy attacks as well as attacks based upon the reasonable expectations of the insured.

Second, we should note that *Kemper* involved a car rental agency, which would likely be deemed to be a sophisticated buyer of auto insurance that would fully appreciate, and perhaps request, a step-down provision that would allow it to meet the law while providing its customers the minimum limits for purposes of saving premium. It is equally likely that the personal purchaser of auto insurance does not understand or request step-down clauses in an auto policy, may not be getting any premium break as a result of the clauses, and would not elect them if they were negotiable.

Third, *Kemper* is a federal decision made before the Montana Supreme Court had addressed step-down provisions. As will be seen below in *Liebrand v. National Farmers Union Property and Casualty Co.*, and *Cole v. Truck Ins. Exchange*,³⁵ the Montana Supreme Court appears to be hostile to the step-down provisions at least insofar as the step-down is aimed at reducing family benefits.

Nonetheless, step-down provisions appeared to receive the Montana Supreme Court's blessing (*in dicta*) in a case that did not involve a step-down clause in 1988. In *Iowa Mut. Ins. Co. v. Davis*,³⁶ the court held a "named-driver" exclusion void as against public policy for violating the Mandatory Liability Insurance Act, § 61-6-301 (since amended to expressly allow named-driver exclusions). Davises had requested to exclude their teenage sons from their policy to avoid high premiums from the risk they presented. However, in voiding the named insured exclusion in that case, the court said:

Our ruling does not, however, prohibit an insurer from entering into agreements with their insureds to limit coverage to the

statutory minimum amounts as set forth in §61-6-103, MCA. Other states have reached similar conclusions.

Arguably, the court was authorizing the insured and the insurer to agree that a specified named-insured could be excluded from excess coverage. However, insurers would read the statement as blanket authorization for step-down clauses.

Accordingly, in the 1994 Federal case of *Shook v. State Farm Mut. Ins.*,³⁷ Judge Hatfield addressed a family step-down clause in the Bodily Injury "Coverage A" of State Farm's policy that read:

There is no coverage: * * * 2. For any *Bodily Injury* to: ... (c) *any insured* or any member of *an insured's* family residing in the *insured's* household to the extent the limits of liability of this policy exceed the limits of liability required by law.

Shooks carried BI limits of \$100,000, but when the wife sued her husband for personal injury negligence, State Farm tendered only \$25,000. Judge Hatfield held that "an exclusionary endorsement which operates to limit coverage to the statutory minimum amounts established by Mont. Code Ann. § 61-6-301 is not violative of the public policy inherent in Montana's mandatory insurance law." However, he found the positioning of the exclusion in relation to the broad language of the basic coverage agreement created an ambiguity and violated the reasonable expectations of the insured.

Soon after *Shook* in 1995, the Montana Supreme Court, on certified questions from the Federal District Court, decided the companion cases of *Liebrand v. National Farmers Union Property and Casualty Co.*, and *Cole v. Truck Ins. Exchange*.³⁸ In each case, family members had been precluded from full liability coverage by

step-down clauses in that coverage. NFU's \$100,000 liability coverage in *Liebrand* excluded "bodily injury to you or any relative to the extent the limits of liability of this policy exceed the limits of liability required by law." Liebrand's declarations page stated that, "[l]iability payments to household members are limited to the Financial Responsibility limits of the policy state."

Coles carried liability limits of \$500,000 under coverage that contained a step-down clause precluding coverage, "Arising out of the liability of any insured for bodily injury to you or a family member to the extent the limits of liability of this policy exceed the limits of liability required by law." T.I.E.'s declarations page gave no notice of the limitation of recovery by family members and showed a \$500,000 limit for bodily injury and property damage liability.

The court applied the test from *Shook*, that determination of whether there is ambiguity requires analysis of the language of the policy "utilized from the viewpoint of a consumer of average intelligence, not trained in the law or in the insurance business."³⁹ The court found that, for people untrained in the law and of average intelligence, the policy language provided no means by which the insured could know the limit of liability available when a family member was the injured claimant. Accordingly, the step-down provisions in each case were held to be "unclear and ambiguous," and declared invalid and unenforceable. The court declined to rule on whether the clauses violated the insureds' reasonable expectations or were void as contrary to public policy of the state.

Most importantly, the court warned that attempts to clarify the step-down provisions would result in a finding of unconscionability because the clauses are inserted in contracts of adhesion and arbitrarily exclude a whole class of insureds from full coverage in a market where they cannot obtain that coverage.

In 2005, Montana District Court Judge Tom McKittrick in the Eighth

Judicial District refused to enforce family step-down clauses in the liability coverage of USAA auto policy for failure to comply with the notice provisions of §33-15-1106.⁴⁰ Though he disposed of the case on failure of notice grounds, he expressly found that the clause, appearing in a contract of adhesion, was also unconscionable and void as against public policy. MTLA member, Charlie Lucero wrote a comprehensive brief attacking the clause on several grounds.

Methods of attacking step-down clauses

A. Invalidity for violating statute

The fact that a step-down clause does not violate a statute setting mandatory minimum limits does not preclude a challenge for violation of another statute. For instance, clauses limiting coverage to the minimum required by the financial responsibility laws arguably violate insurance code provisions forbidding reference to other provisions. In Montana, § 33-15-302 requires that "the policy when issued shall contain the entire contract between the parties" and there cannot be "any agreement as to the insurance which is not plainly expressed in the policy." Also, § 33-15-316 provides that "Every insurance contract shall be construed according to the entirety of its terms and conditions as set forth in the policy and as amplified, extended, or modified by any rider, endorsement, or application which is a part of the policy." As the Montana Supreme Court pointed out in the *Liebrand* and *Cole* cases, an insured unschooled in the law cannot tell by looking at his or her policy how much coverage it affords family members if a step-down clause reduces the family member's limit to that set by "financial responsibility laws" as opposed to the dollar limit appearing on the declarations page.

Section 61-6-103(4) requires that "A motor vehicle liability policy must state the name and address of the named insured, the coverage afforded

by the policy, the premium charged therefore, the policy period, and the limits of liability and contain an agreement or be enforced that insurance is provided thereunder in accordance with the coverage defined in this part as respects bodily injury and death or property damage, or both, and is subject to all the provisions of this part." Does a step-down clause simply referring to the Financial Responsibility Act state the "coverage afforded" and the "limits of liability?"

The South Dakota Supreme Court invalidated a step-down clause for permissive users because it constituted a "restrictive endorsement" which, under the South Dakota Insurance Code, was required to appear on a separate page attached to the policy instead of in the body of the policy itself. *Mid-Century Insurance Company v. Lyon*, (1997).⁴¹ Montana does not appear to have a similar requirement for restrictive endorsements other than, under § 33-15-316, reference to endorsements must appear on the declarations page as part of the policy.

When a step-down clause is inserted into the policy by renewal or any type of endorsement, it is subject to statutory notice requirements as a condition to enforcement because the policy is clearly being renewed on "less favorable terms." Section 33-15-1106, MCA provides for statutory notice of changes on renewal:

Renewal with altered terms. (1) If an insurer offers or purports to renew a policy on less favorable terms, at a higher rate, or at a higher rating plan, the new terms, rate, or rating plan take effect on the policy renewal date only if the insurer has mailed or delivered notice of the new terms, rate, or rating plan to the insure at least 30 days before the expiration date.

Judge McKittrick in the Eighth Judicial District recently refused to enforce family step-down clauses in the

liability coverage of the USAA auto policy for failure to comply with the notice provisions of § 33-15-1106.

In *Shelter Mutual Insurance Company v. Mid-Century Insurance Company*,⁴² the Colorado court refused to enforce a step-down clause aimed at a permissive user on the ground that information given on renewal did not constitute an adequate notice to the insured that his insurance had been substantially reduced. The questions for counsel are whether the company gave notice and whether the information given is sufficient to constitute notice.

The Appellate Division of the Superior Court of New Jersey ruled notice inadequate in *Skeete v. Dorvius*,⁴³ (2004), where Prudential sent the insured some 200 pages of renewal documents in two weeks. The documents contained a handful of unremarkable paragraphs noting the step-down provisions but made no mention of them on the new declarations page. The court refused to enforce the step-down clause.

B. Invalidity for violation of public policy aside from the statute

Statutes aside, a step-down clause can be stricken if it violates judicially stated public policy. *Tissell v. Liberty Mutual Ins. Co.*,⁴⁴ (Wash. 1990). In *Tissell*, the court invalidated a family exclusion clause in UIM coverage while stating some important principles. The court said:

An insurer is free to limit its risks by excluding coverage when the nature of its risk is altered by factors not contemplated by it in computing premiums, such as the use of a vehicle by an unauthorized driver. The family or household exclusion, by contrast, is directed at a class of innocent victims who have no control over the vehicle's operation and who cannot be said to increase the nature of the insurer's risk. An exclusion

which denies coverage when certain victims are injured is violative of public policy.

*** Since the fact that the victim is a member of the insured's family does not subject the insurer to an indeterminate risk, the insurer is able to calculate an appropriate premium and the general policy of full compensation for accident victims still applies

One of the most cogent and simple formulations of how the family step-down clause violates public policy was articulated by the Supreme Court of New Mexico in *State Farm Mutual Auto Insurance Company v. Ballard*, 132 N.M. 696, 54 P.3d 537 (2002). The court found invalid the family exclusion that reduced to minimum liability limits family recovery for a mother and two children grievously injured in a single car collision caused by negligence of the driver. The court rejected the premise that the only public policy involved was that reflected in the New Mexico Motor Vehicle Financial Responsibility Act. The court instead applied the public policy of protecting innocent accident victims. The court noted that it had rejected intra-familial tort immunity and asserted that familial exclusions are an anachronism, "because the reasons for the rule are no longer valid." The court also rejected the freedom of contract argument since insurance contracts are not the result of any conscious bargaining on the part of the insured. The court bluntly asserted that Carol Ballard did not purchase minimum limits but, rather, purchased 100/300 limits of liability insurance. It concluded that, while the step-down clause may not violate the policy underlying the minimum limits of New Mexico's Financial Responsibility Act, it violates the principle of protecting the innocent victims of auto accidents. The court quoted its decision in *Estep*

v. State Farm Mut. Auto. Ins. Co.,⁴⁵ where it said:

Since a wife in this jurisdiction has a cause of action for injuries suffered because of her husband's negligence, it is difficult to discern how a fundamental public policy purpose of the Financial Responsibility Act, i.e., to provide financial protection to those who sustain injury through the negligence of motor vehicle owners or operators - is served, or how the requirement of the Act, i.e., to provide proof of financial responsibility for losses from liability imposed by law which arise from the use of an insured motor vehicle - is observed, when the family exclusion clause in the policy specifically carves out from coverage a considerable segment of the class of individuals the NMMFRA is designed to protect.

Ultimately, the New Mexico court held that family exclusion provisions limiting benefits "based on familial status, violate public policy and fundamental principles of fairness."

Another court seems to take the position that permissive user step-down clauses are against public policy solely on the ground that, "if an insurance company offers coverage above the statutory minimums, it cannot selectively restrict those limits based on who was driving the automobile." *Home Insurance Co. v. McGovern*, (E.D.Pa. 1993).⁴⁶ The public policy there was apparently based in a statute that prohibited an insured from purchasing greater limits of UM/UIM coverage than BI coverage. Montana has no such statute, but the author believes that insurers in Montana will not sell insureds greater UM/UIM than the BI they purchase.

We should note that, in *Stutzman v. Safeco Ins. Co.*,⁴⁷ the court upheld a family exclusion in Underinsured

Motorist coverage. There, the definition of "underinsured motor vehicle" provided:⁴⁸

But underinsured motor vehicle does not include any motor vehicle: ... (3) owned by or furnished for the regular use of the named insured or any relative...

Stutzman was suing her husband, John Turcotte, for damages she suffered arising from his negligence in operating a motor vehicle in which she was a passenger. She cited *Transamerica v. Royle* for the proposition that the family exclusion was invalid as violative of public policy in Montana. However, the court refused to invalidate the family exclusion for underinsured motorist coverage on the ground that "there is no statutory mandate for underinsured motorist coverage in Montana." Stutzman also argued that the household exclusion to UIM coverage was unconscionable because it prohibited her from recovering the UIM benefit solely because it was her husband who injured her (as opposed to a third party). The court disagreed saying that she had the "meaningful choice" of purchasing additional liability insurance. To rule otherwise, the court said, would be to convert the UIM coverage into liability coverage, a step the court was unwilling to force on insurers.

UIM coverage is not the subject of any statutory mandate in Montana. Consequently, if a family or household exclusion defeats the coverage, counsel has no UIM statute to use as a basis for a challenge of violation of public policy. However, other provisions defeating underinsured motorist coverage have been successfully attacked on other public policy grounds that may apply. For example, in *Bennett v. State Farm Mut. Auto. Ins. Co.*⁴⁹ (1993), the court invalidated an "other insurance" clause that would have prevented the stacking of a husband and wife's respective limits of UIM coverage on their two cars. The court said:

The public policy embodied

in these decisions is that an insurer may not place in an insurance policy a provision that defeats coverage for which the insurer has received valuable consideration.

The court, in *Bennett*, refused the argument that such public policy does not apply to UIM because it lacks the protection of a statutory mandate, and said:

We disagree. The purpose of underinsured motorist coverage is to provide a source of indemnification for accident victims when the tortfeasor does not provide adequate indemnification. The public policy expressed in *Braun*, and in the earlier cases cited above, favors adequate compensation for accident victims. The absence of a statutory requirement is irrelevant, for the public policy considerations that invalidate contractual "anti-stacking" provisions in an uninsured motorist endorsement also support invalidating those provisions in an underinsured motorist endorsement.⁵⁰

Finally, the court rejected the insurer's assertion that Bennetts had no reasonable expectation of stacking their UIM coverages by citing the court's previous finding of violation of reasonable expectations in *Transamerica v. Royle*. There, the court invalidated a family exclusion on the ground that "it did not honor the reasonable expectations of the insured."⁵¹ Simply stated, Montana has judicially recognized public policy that favors adequate compensation for accident victims. The insurers use of a step-down family exclusion in UIM coverage must not run afoul of that public policy.

It appears that the use of step-down provisions is increasing, leaving insureds in the perilous position of not understanding that they only carry

minimum limits in certain circumstances. If the trend continues, and it will unless the courts intervene, even insurance consumers skilled enough to understand the import of the step-down clauses may not have full coverage alternatives in the market. As unfair as this sounds, insurers will argue that their premiums reflect the reduced risk that the step-down clauses supposedly provide.⁵² That argument is highly suspect and will likely require counsel undertake discovery to find whether there is any actuarial basis to that claim.

C. Invalidity because of ambiguity

Insurance contracts are contracts of adhesion. Consequently, in cases of ambiguity, these contracts are construed against the drafting insurer. They are deemed ambiguous if, when taken as a whole – in wording and phraseology – they are subject to two different interpretations.⁵³ Under Montana law, the test for interpreting an ambiguous insurance contract is not what the insurer meant the words of the policy to mean but what a reasonable person in the position of the insured would understand the words to mean. Hence, the determination requires examination of language utilized from the viewpoint of the consumer of average intelligence, not trained in law or in insurance business.⁵⁴ While the policy is to be construed liberally in favor of the insured and in favor of extending coverage,⁵⁵ exclusions from insurance coverage are to be narrowly and strictly construed.⁵⁶

The court in *Hardy v. Progressive Specialty Insurance Co.*,⁵⁷ (2003) said:

From a consumer's point of view, a declarations page may be his or her only plain and simple source of information and, if misleading, is of no value. A declarations page which suggests coverage in an amount which is not actually available is misleading.

In *Shook v. State Farm Mut. Ins.*, Judge Hatfield ruled that family step-down clause invalid on a finding that the policy was ambiguous given the positioning of the exclusion in relation to the broad language of the basic coverage agreement. He coupled that finding with a finding that the insurer's reading of the policy violated the reasonable expectations of the insured. The Montana Supreme Court in the *Liebrand* and *Cole* cases declared the step-down provisions "unclear and ambiguous," holding them invalid and unenforceable.

Shook appeared to recognize structural ambiguity in insurance policies, saying: "While the court is not persuaded by the argument of structural ambiguity presented by Shook, it does agree that the positioning of the exclusion, in relation to the general coverage provision, lends itself to the creation of the ambiguity in the exclusion." The court cited with approval the Arizona court's test for structural ambiguity:

[T]he Arizona court established three rules relative to the determination of whether a structural ambiguity rendered a policy unenforceable:

(1) Although the provisions in question were unambiguous by

themselves, the average consumer attempting to check on his or her rights could not readily understand them because of their location in the policy;
(2) The provision in question could be deemed unexpected or one that emasculated apparent coverage; and
(3) The provision may well have undercut the purpose of the transaction or even the dickered deal between the insureds and the insurer.⁵⁸

While ambiguity is in the eye of the court, it seems hard to imagine a step-down family exclusion that would not be violative of at least (2) and (3) above.

A California court in *Haynes v. Farmers Insurance Exchange*,⁵⁹ (2004) held Mid-Century's step-down clause for permissive drivers to be structurally ambiguous when attempting to interpret the declarations page, basic insuring agreement, limitation of liability clause, other insurance clause, and amendatory endorsements affecting those clauses.

Liebrand v. National Farmers Union Property and Casualty Co., and *Cole v. Truck Ins. Exchange*, were both decided on ambiguity. The court specifically noted that the step-

down clause limiting family member recovery to the limits of the Financial Responsibility laws left one unschooled in the law with no way to know the amount of benefits available to the insured's family members. However, other courts in Kansas in *Brooks v. Bennett*⁶⁰ (2001) and Iowa in *Krause v. Krause*,⁶¹ have held that use of the generic phrase "Financial Responsibility Law" does not render the clause unclear and ambiguous.

In *Krause*, the Supreme Court of Iowa found the step-down family exclusions to be clear and unambiguous where the clause referenced "the limit specified in the financial responsibility law" of the state instead of a specific dollar amount. The *Krause* case featured a full family exclusion clause in the Bodily Injury coverage, which blocked Debra Krause from recovering any part of a \$1,284,456 default judgment for her severe personal injuries caused by her husband's negligence in operating the automobile in which she was a passenger. She then made a claim against the policy's Uninsured Motorist coverage. However, a step-down family exclusion to the UM coverage limited her recovery to the state's minimum limits under the financial responsibility law (\$20,000) instead of the \$100,000/\$300,000 limits of the declarations page. The court noted that it had

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previously ruled the family exclusion valid and not violative of public policy. Consequently, it overturned the trial court's finding that the clause was ambiguous. The endorsement in *Krause* actually provided that, if there was no BI coverage because of the family exclusion, and a family member made a UM claim, then the UM limit available was stepped down to the minimum required under the Motor Vehicle Financial Responsibility law. The court found that the language was not ambiguous even though it conceded the failure to state a dollar limit was "vague," holding that there could only be one interpretation of the clause, and that was the insurer's.

D. Invalidity for violating the insured's reasonable expectations

The *Krause* court also found that Debra Krause had no reasonable expectation of coverage. However, the prerequisites to finding violation of the consumer's reasonable expectations in Iowa are that the doctrine "can only be invoked when an exclusion (1) is bizarre or oppressive, (2) eviscerates terms explicitly agreed to, or (3) eliminates the dominant purpose of the contract." The court found none of these conditions were met in IMT's design of the policy. Nevertheless, it would be hard to imagine that when Krauses purchased 100,000/300,000 limits of BI and UM coverage, they envisioned their family members would receive \$0 under the BI and \$20,000 under the UM.

The court in *Shook* assumed that the reasonable expectations doctrine may be used in Montana to resolve ambiguities.⁶² However, it is also important to note that the court in *Transamerica v. Royle* invalidated the household exclusion because the clause "failed to honor the reasonable expectations of the purchaser of the policy."⁶³ The court in *Royle* did not find any ambiguity, and the author's belief is that the Montana Supreme Court does not require ambiguity as a precondition

for voiding a clause for violating reasonable expectations of the insured.⁶⁴

As the Missouri court said in *Husch v. Nationwide Mut. Fire Ins. Co.*⁶⁵

When purchasing uninsured motorist coverage, policyholders are primarily concerned with protecting themselves, their spouses, and their minor children, i.e. the natural family unit. Minor children are unable to insure themselves and thus provide financial protection against disabling injuries.

A step-down clause defeats that primary concern and surely violates the insured's reasonable expectations. The Kentucky Supreme Court in *Lewis v. West American Ins. Co.*,⁶⁶ said:

Consumers purchase liability insurance coverage in excess of the mandatory amounts required by law out of a sense of personal, financial, and social responsibility. By purchasing higher liability insurance limits, the insured provides a method to compensate those injured as a result of the insured's negligence without endangering the financial security earned by years of hard work. Purchasers of automobile insurance expect their family members to receive comparable protection to that afforded to unknown third persons. Family exclusions defeat these goals and render liability insurance coverage illusory for those persons the insured most desires to protect, who are also the persons most likely to be passengers in the insured's vehicle, the insured's loved ones.

In *Lewis v. West American Ins. Co.*, the Supreme Court of Kentucky was asked to apply the modified family exclusion to deny liability coverage over the mandatory minimum \$25,000. The

case involved a nine-year-old girl who had been brain damaged. She was a passenger when a car driven by her mother collided with a tractor-trailer. The court invalidated the family exclusion outright, noting that, just as fraud and collusion had not justified the guest statutes and family immunity tort statutes, they did not justify the family exclusion in auto liability policies. The reasoning in *Lewis* is so compelling that it deserves quoting at length:

As a result, an insurance policy containing such a clause prevents a specific class of innocent victims from receiving adequate financial protection. This exclusion is entirely based upon the person's status as a member of the named insured's family. Without documentation or factual basis, every member of this excluded class is labeled high risk and branded as being more likely to engage in collusion and fraud.

The *Lewis* court quoted the Washington Supreme Court reasoning in *Mutual of Enumclaw Ins. Co. v. Wiscomb*.⁶⁷

This exclusion becomes particularly disturbing when viewed in light of the fact that this class of victims is the one most frequently exposed to the potential negligence of the named insured. Typical family relations require family members to ride together on the way to work, church, school, social functions, or family outings. Consequently, there is no practical method by which the class of persons excluded from protection by this provision may conform their activities so as to avoid exposure to the risk of riding with someone who, as to them, is uninsured.

The court went on to say.⁶⁸

Many of the people denied insurance coverage are innocent children who have no say about the vehicle in which they are placed, who drives the vehicle, or the manner in which the vehicle is driven. Furthermore, because of their tender years, in many cases they are incapable of fraud or collusion. Despite these considerations, family exclusion clauses deny them the full protection provided by insurance policies.

As the author has said before, "The policies being contracts of adhesion, the consumers have no choice and may not avoid being exposed to the risk of riding with a family member who is, as to them, uninsured or underinsured while being fully insured as to neighbors and strangers."⁶⁹

In *Transamerica v. Royle*, the court, after ruling the household exclusion invalid for violation of the Mandatory Liability Protection Act, added that it also was invalid due to "its failure to 'honor the reasonable expectations' of the purchaser of the policy." The court in *Royle* quoted Professor Keeton's famous underpinning for the reasonable expectations doctrine:⁷⁰

The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."

As the Federal Court in Montana said in *Shook*, "The objectively reasonable expectations of the purchaser are 'honored [in Montana] notwithstanding the fact that a 'painstaking study' of the policy would [negate] those expectations.'" In *Shook*, the court found the State Farm step-down family exclusion to the Bodily Injury Liability Coverage to be ambiguous because a reasonable insured might read the exclusion, "There is no coverage . . .

2. For Any *Bodily Injury* to: . . . c. *any insured* or any member of *the insured's* family residing in the *insured's* household. . .", to mean no indemnification or defense to an insured or family member who is sued. The insurer argued it could only mean the insured could not make a claim for injury under the coverage. Having found the provision ambiguous, the court subjected it to the reasonable expectations test. It noted that the exclusion was separated "both in space and relation" from the broad basic insuring agreement, which promised that State Farm would "[P]ay damages for which an *insured* becomes legally liable to pay because of: a. *bodily injury* to others," and therefore, violated the insured's reasonable expectations.

In the Arizona case of *Averett v. Farmers Ins. Co.*,⁷² the court overturned a summary judgment for the insurer that relied on a family exclusion to the liability coverage and remanded the case for trial. The Averett children were seriously injured passengers in an accident in which their mother, who was driving, was killed. Their father had ordered from the agent, "full coverage" for his entire family, and the agent sold him \$250,000 per person limits of BI coverage, subject to a step-down family exclusion that reduced the children's recovery to minimum mandatory \$15,000 apiece. The Arizona court set out four situations in which it would not enforce such exclusions, even if unambiguous, if they violated the customer's reasonable expectations.⁷³ Those were: (1) where the unambiguous policy term cannot be understood by the reasonably intelligent consumer; (2) where there is inadequate notice of a term that is unusual, unexpected or that emasculates apparent coverage; (3) where conduct of the insurer would "create an objective impression of coverage in the mind of a reasonable insured"; and, (4) where activity of the insurer has induced the reasonable belief in coverage, though "expressly and unambiguously denied by the policy."

E. Unconscionability

Unconscionability appears to be a viable approach to attacking step-down provisions in Montana given the court's dicta in the cases of *Liebrand v. National Farmers Union Property and Casualty Co.*, and *Cole v. Truck Ins. Exchange*, discussed above. As the court said in *Iwen v. U.S. West Direct*:⁷⁴

[f]or such contracts to be enforced against the weaker bargaining party, they must pass a two-prong test for validity. We stated that test as follows;

For such a contract or clause to be void, it must fall within judicially imposed limits of enforcement. It will not be enforced against the weaker party when it is: (1) not within the reasonable expectations of said party, or (2) within the reasonable expectations of the party, but, when considered in its context, is unduly oppressive, unconscionable or against public policy.

Unconscionability requires a two-fold determination:

That the contractual terms are unreasonably favorable to the drafter and that there is no meaningful choice on the part of the other party regarding acceptance of the provisions.⁷⁵

In invalidating the family step-down clause in USAA's policy in *Topp v. United Services Automobile Association* reported above, Judge McKittrick also expressly held the step-down clauses in the liability coverage of USAA auto policy to be unconscionable. He noted the deposition testimony of USAA's officer that: (a) the exclusion clause was part of a standard agreement; (2) that Topp's were unable to negotiate the agreement; and (3) that the insured's only choice was to accept or reject the agreement.

Conclusion

Step-down clauses that reduce the recovery of family members to minimum limits and protection of permissive users to minimum limits are subject to challenge for being unfair, unconscionable, violative of public policy, violative of reasonable expectations, and for creating ambiguity in an auto policy. They only impact those insureds who, for their own security, elected to carry more than the minimum limits of auto insurance. Yet, with regard to the affected coverage, the security conscious insured is no better off than the insured who chose minimum limits. It is unlikely that any such insured would buy a policy with step-down provision if the insurance agent told them that the policy would provide their family or permissive user less insurance than they are buying for others. Moreover, the primary justifications for the family exclusion are those long ago rejected by the courts in abrogating intra-family tort immunity. The clauses arbitrarily exclude from coverage a large class of persons most likely to be riding in the insured vehicles.

Nevertheless, it is ironic that insurers are increasingly inserting step-down clauses into the BI, UM, and UIM coverages on policies issued in Montana. The provisions are vulnerable to attack on several valid grounds and need to be scrutinized by the Montana Supreme Court.

It is hard to see the justification for the family step-down provisions. The seemingly rational justification for the permissive user step-down is that the insurer has no way of knowing who will be driving for purposes of calculating risk. But, based on previous year's experience, the auto insurer can predict to a reasonable degree of accuracy what its losses will be this year by reason of negligence of permissive users. The insurer also does not know which autos will be in accidents next year, but it can predict with high accuracy how many will be and what the dollar losses will be.

As always, success will come from well honed arguments and briefs that expose the fallacies and unfairness behind step-down clauses. It will be interesting to see which, if any, Montana auto insurers are willing to risk an appeal on the clauses. The sad part is that the clauses likely reduce benefits to many an unrepresented family member or victim of a permissive insured's negligence. Insurance enforcement is a never-ending and always-necessary task.

ENDNOTES

1. The author thanks law student researcher, Christopher Orman, and editors Dan Buckley and Pat Sheehy for review and editing and Gary Zadick for review and comment.

2. Dobbs, *THE LAW OF TORTS*, Vol. 1, § 279-280 (West Group 2001).
3. *Id.*
4. *Id.*
5. 222 Mont. 214, 721 P.2d 342 (1986).
6. 202 Mont. 173, 656 P.2d 820 (1983).
7. See, Munro, The "Household" or "Family" Exclusion in Auto Policies, *TRIAL TRENDS*, Autumn 2000.
8. Invalidating the Family or Household Exclusion in Auto Insurance, *TRIAL TRENDS*, Spring 2001.
9. The Automobile Liability Coverage Step-Down Clause: The Real Deal or Merely the Calm Before the Storm, 10 Geo. Mason L. Rev. 33,42 (2001-02).
10. *Id.*
11. MCA § 61-6-301 (2007).
12. MCA § 33-23-201 (2007).
13. 202 Mont. 173, 656 P.2d 820.

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14. *Id.* at 177, 656 P.2d at 823.
15. 282 Mont. 376, 938 P.2d 631 (1997).
16. MCA § 33-23-201 (2007).
17. 872 F. Supp. 786 (1994).
18. 124 N.M. 36, 946 P.2d 240 (N.M. Ct. App. 1997).
19. 132 N.M. 696, 54 P.3d 537.
20. 272 Mont. 1, 898 P.2d 1220 (1995).
21. form No. 9608 MT (2001).
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23. 24 S.W.3d 151, 153 (Mo.App.E.D.)
24. *Miller v. Mid-Century Ins. Co.*, Gallatin County Civil Cause DV-04-367.
25. *Parker*, 10 Geo. Mason L. Rev. at 43.
26. *Id.*
27. *Id.* at 44.
28. *Miller v. Mid-Century Ins. Co.*, Civil Cause DV-04-367, order of July 18, 2006.
29. 667 F.Supp.714 (D.Mont. 1987).
30. 213 Mont. 99, 689 P.2d 1237 (1984).
31. 667 F. Supp. at 717.
32. *Id.*
33. 897 S.W.2d 119 (Mo.Ct. App.1995).
34. See, also, *Liberty Mutual v. Sanford*, 879 S.W.2d 9 (Tex. 1994).
35. 272 Mont. 1, 898 P.2d 1220 (1995).
36. 231 Mont. 166, 752 P.2d 166 (1988).
37. 872 F.Supp. 768 (D Mont. 1994).
38. 272 Mont. 1, 898 P.2d 1220 (1995).
39. 872 F.Supp. at 773-74.
40. *Topp v. United Services Automobile Association*, Civil Cause CDV-01-1205(A).
41. 562 N.W.2d 888 (1997).
42. 2008 WL 5173326 (Colo. App. 2008).
43. 845 A.2d 1265 (2004).
44. 795 P.2d 126 (Wash. 1990).
45. 103 N.M. 105, 107-111 (N.M. 1985).
46. 837 F.Supp. 661(E.D. Pa. 1993) citing, *Keystone Ins. Co. v. Atlantic Chrysler Plymouth, Inc.*, 400 A.2d 872 (Law Div. 1979).
47. *Stutzman*, 284 Mont. 372, 945 P.2d 32 (1997).
48. *Id.* at 378, 945 P.2d at 35.
49. *Bennett*, 261 Mont. 386, 862 P.2d 1146 (1993).
50. *Id.* at 389, 862 P.2d at 1148. Citing, *State Farm Mut. Auto. Ins. Co. v. Estate of Braun*, 243 Mont. 125, 793 P.2d 253 (1990).
51. *Id.* at 390, 862 P.2d at 1149.
52. See, Kevin Black, *Lewis v. West American Insurance Co.: Public Policy or Insurance Policy?*, 24 N.Ky.L.Rev. 333 (1997) for an opposing point of view on family exclusions.
53. *Canal Ins. Co. v. Bundy*, 249 Mont. 100, 813 P.2d 974 (1991).
54. *Grindheim v. Safeco Ins. Co. of America*, 908 F.Supp. 794 D.Mont. 1995).
55. *Mitchell v. State Farm*, 293 Mont. 140, 974 P.2d 623, 628 (1999).
56. *Enron Oil Trading & Transp. Co. v. Walbrook Co., Ltd.*, 132 F.3d 526 (D. Mont. 1997).
57. 315 Mont. 107, 67 P.3d 92 (2003).
58. *Gordinier v. Aetna Cas. & Sur. Co.*, 742 P.2d 277, 284-85 (Ariz. 1987).
59. 89 P.3d 381 (Cal. 2004).
60. 26 P.3d 73 (Kan. App. 2001).
61. 589 N.W.2d 721 (Iowa 1999).
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66. 927 S.W.2d 829 (Ky. 1996).
67. 643 P.2d 441 (Wash.1982).
68. *Id.*
69. See, Munro, Invalidating the Family or Household Exclusion in Auto Insurance, TRIAL TRENDS Spring 2001, for comprehensive arguments against family exclusions.
70. 202 Mont. at 179, 656 P.2d at 824.
71. 872 F.Supp at 774 citing *Wellcome v. Home Ins. Co.*, 257 Mont. 354, 358, 849 P.2d 190,193 (1993).
72. 869 P.2d 505 (Ariz. 1994).
73. *Id.* at 507.
74. 293 Mont. 512, 519-20, 977 P.2d 989, 994-95 (1999) [quoting *Passage v. Prudential-Bache Securities, Inc.*, 223 Mont. 60, 66, 727 P.2d 1298,1302 (1986)].
75. 293 Mont. at 521, 977 P.2d at 995 [quoting *Liebrand v. National Farmer's Union Property & Casualty Co.*, 272 Mont. at 12-13, 898 P.2d at 1227].

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